ABSTRACT

The Spanish real estate market has been a major target of institutional investors in recent years. This paper focuses on studying the degree of institutionalization of the Spanish student housing market through the study of 4 hypothesized determinants: the disappearance of the capitalization rate premium over traditional real estate asset classes, the professionalization of the supply, the substitution of direct investment vehicles for indirect investment vehicles and the consolidation of student housing companies and investors. Moreover, it provides a comparison with the American and British student housing markets. Our findings suggest that the market is not fully institutionalized, but it is showing a positive trend towards this status.

Key words: student housing, real estate investments, institutionalization, real estate investment vehicles, capitalization rate premium, real estate institutionalization, REITs, supply-demand mismatch
1. Introduction

Institutional investors (e.g. pensions funds, sovereign wealth funds, mutual funds, insurance companies and other financial institutions) pool excess capital from individuals and/or firms to invest in diversified portfolios of different asset classes. While most capital is allocated to stocks and fixed-income securities (e.g. corporate bonds and public debt), real estate has an increasing importance in these portfolios. There are three main general advantages of real estate investment for institutional investors. First, it allows for improved diversification and lower portfolio risk. Moreover, investment in real assets can periodically render cash-flows to the portfolio (e.g. rental income). Finally, real properties appreciate, on average, faster than the Consumer Price Index (CPI), thus offering an effective hedge against inflation (Andonov, Kok and Eichholtz, 2013).

The Spanish real estate market collapsed as a result of the 2008 global financial crisis and the subsequent European debt crisis. Investment volumes hit a rock bottom in 2012, with a mere €3 billion for all property sectors, according to CBRE Research (2019b). Since then, however, the Spanish real estate market is in a six-year growth phase, with retail properties, office space, residential assets and hotels attracting most investment. Indeed, the Spanish real estate market attracted a record €15.2 billion from international investors, representing 1.26% of the GDP (Expansión, 2019).

The Spanish real estate sector is now entering a mature stage, although less mature than other markets. With higher than average yields across most property sectors and competitive real asset prices, the Spanish market is expected to continue to offer advantageous opportunities for all real estate investors, including institutional ones.

In their pursuit of maximizing the risk-adjusted return of their portfolios, institutional investors have progressively incorporated alternative asset classes to their real estate holdings (Newell and Marzuki, 2018). In particular, student housing assets (i.e. dorms and purpose-built student apartments and single-family homes) have been the focus of increased competition among global investors. While the American and British markets have drawn most capital, the Spanish student housing market is in the midst of a rapid growth period, with investment volumes (including transactions) increasing by 1,120% from 2016 to 2017 (JLL, 2018).

The purpose of this project is to analyze to which extent the Spanish student housing market is institutionalized. In section 2, we provide a theoretical framework explaining key concepts in real estate finance and theories on business consolidation, which will enable us to analyze and draw conclusions later. In section 3, we present what we believe are the main features of an institutionalized student housing market. Section 4 provides a thorough analysis of the Spanish student housing market,
explaining the reasons for the recent institutionalization of the sector and providing insights on how the process has unfolded. Besides, said section includes a direct comparison of the hypothesized determinants of institutionalization with those in the American and British market, which show a higher degree of institutionalization. In the conclusions, we offer a summary of our findings.

2. Conceptual framework

In order to carry out the study of the Spanish student housing market, it is important to first overview the main theoretical concepts that will be used. In this section, we will define thoroughly the real estate investment vehicles in the Spanish market, M&A drivers and valuation methods for real estate assets.

A. Real estate investment vehicles in Spain

For many years, real estate investments have been performed by individual investors. Over time, more complex real estate investment vehicles have appeared in the Spanish market, with different legal requirements and purposes. In this section we will be introducing the main investment vehicles.

Real Estate Investment Funds – Fondos de Inversión Inmobiliaria (FIIs)

Real estate investment funds pool capital from investors and invests it in securities offered by public real estate companies. Their main objective is to create corporations that can develop the housing rental market through the investments of medium and small size investors. The main difference with most publicly listed companies is that funds are externally managed. A contract is put in place between the fund manager and the assets (Baum, 2009).

“FIIs have an open structure with variable (not limited) capital and free in-out contribution movements whereby participants can disinvest at any time” (Taltavull de la Paz, Peña Cuenca, 2013).

There are some legal requirements for entities to qualify as real estate investment funds. The first is to invest 70%-90% of the total equity in the real estate rental market (real estate rights, options and participations in developments). The minimum initial capital is €9 million, 100 is the minimum number of stakeholders and there is a limitation of a 50% leverage on total funds. There needs to be a minimum of four real estate projects inside the real estate investment fund and none of them must account more than 35% of the total assets. They must maintain real estate projects for a minimum period of 3 years on a rental basis or, in the case of own developments, 7 years.
**Real Estate Investment Trusts – Sociedades de Inversión Inmobiliaria (SIIs)**

Real Estate Investment Trusts are entities with a Board of Directors responsible for the management decisions and with a closed-ended structure which limits the number of shares that are issued. They are very similar to Real Estate Investment Funds, with the difference that the minimum investment in real estate is larger (90% in SIIs vs. 70% in FIIs).

**Mortgage-backed securities funds**

Mortgage-backed security funds are real estate instruments that provide a return to investors secured by the collection of mortgage payments.

**SOCIMIs**

SOCIMIs or “Sociedades Cotizadas Anónimas de Inversión en el Mercado Inmobiliario” are the Spanish version of REITs, introduced by the 11/2009 Act of 26 October. This regulation was very similar to the US-REIT but with a number of restrictions.

SOCIMIs are real estate investment vehicles that allow investors to buy shares of a commercial real estate portfolio and receive income from it. These portfolios may include apartments, student housing, offices, data centers, hotels and other infrastructures. SOCIMIs own spaces, operate them, collect rents and distribute the income that has been generated among the shareholders of the REIT.

The 11/2009 Act of 26 October and the 16/2012 Act of 27 December dictates requirements for entities to qualify as SOCIMIs. These are very similar to the ones required by the American REITs. SOCIMIs must be “listed on a regulated market in Spain, in the European Union or on a regulated market of any country or territory where there is an actual exchange of tax information uninterruptedly for the entire tax period” (EPRA, 2018).

Their minimum capital stock requirement is €5 million, and shareholders can give in-kind contributions (properties). They must invest at least 80% of the total assets in urban real estate for rental, other SOCIMIs and Spanish or foreign qualifying subsidiaries and real estate collective investment schemes. Qualifying assets must be owned by the SOCIMI for, at least, 3 years.

At least 80% of the income must be obtained from own property rentals or other SOCIMIs dividends or yields. Also, 50% of capital gains must be paid out as dividends. They can own at least one property on a rental basis, they can issue nominative shares and there are no leverage restrictions.
B. M&A and M&A drivers

This section will build on the core motives for M&A activity in general, highlighting the particularities of the real estate industry. These particularities will be used to understand why consolidation takes place and how it plays an important role in an institutionalized student housing market.

Motives for M&A activity are of a great research interest. Different papers provide for a large number of very diverse answers. The most common form of classifying these motives is in two large groups: neoclassical theories and behavioral theories (Bernile and Baugess, as cited in Anderson, Medla, Rottke and Schiereck, 2012). Both frameworks are considered valid by scholars and are non-excluding. In fact, M&A activity tends to find motives in both frameworks (Berkovitch and Narayanan, as cited in Anderson, Medla, Rottke and Schiereck, 2012).

Neoclassical theories

Under the neoclassical perspective, M&A is a consequence of firms reacting to external shocks. These shocks can be economic, technological, legal, environmental, political, etc. (Harford, as cited in Anderson, Medla, Rottke and Schiereck, 2012). Firms are expected to behave in a profit-maximizing manner: if a specific firm decides to perform M&A activity in response to a shock, it is understood that this is done purely on behalf of profits and shareholder value (Martynova and Renneboog, as cited in Anderson, Medla, Rottke and Schiereck, 2012).

One of the reasons under the neoclassical theory is that two companies can obtain synergies by working within the same boundaries. Synergies refer to the increase in overall efficiency obtained by combining business activities. One type of synergy are economies of scale, which are cost advantages reaped by larger and more efficient companies. Another type of synergies is tax efficiency (Allen and Sirmans, as cited in Anderson, Medla, Rottke and Schiereck, 2012).

Other relevant motives for M&A relate to inefficient management. If a firm is being inefficiently managed, there might be a lot of unlocked potential in it. This potential can be leveraged by an acquiring firm that has the managerial knowledge necessary to exploit the opportunity. Another very important motive that needs to be highlighted under the neoclassical theories is the importance of supply chain control. Enlarging the scope of control over various steps of the supply chain allow a firm to gain pricing power.

The last and maybe the most important set of motives under the neoclassical perspective is related to market power. Firms with more market power are able to charge mark-ups on their prices. When an industry’s revenues stagnate, inorganic growth through M&A becomes the most feasible way to gain
market power. Acquiring a target firm will also have a positive effect for the acquirer when the target firm is a direct competitor, as it will automatically lower competition.

Behavioral theories
Behavioral theories highlight the principal-agent problem as a source for M&A motives. These motives are, in general, value-destroying for the firm. The key reasoning is that consolidation activity is solely performed by the management team (the agent) in its own benefit, drifting away from owners’ interests (the principal) (Jensen, as cited in Anderson, Medla, Rottke and Schiereck, 2012).

The most relevant motive that is usually cited under behavioral theories is empire building. Larger power and reputation come with larger companies. It is understood, under the behavioral framework, that M&A activity is performed even though it is not value-adding to the firm (Roll, as cited in Anderson, Medla, Rottke and Schiereck, 2012). Managerial salaries and bonuses tend to be tied to firms’ performance. It is found that the key indicator used for compensation is sales growth. When organic growth is limited, M&A provides a useful way for managers to “cheat” their way around. Also, it is common that large firms offer the best compensation packages, making it even more attractive to construct larger corporations through inorganic growth (Mueller, as cited in Anderson, Medla, Rottke and Schiereck, 2012).

C. Real estate valuation methods

Real estate appraisal is a process aimed at determining the estimate of the value of a specific real asset. Real estate properties can be valued in a variety of methods. We now provide an overview of the three more generally used approaches in real estate valuation, based on Brueggeman and Fisher (2010).

The sales comparison approach uses recent sales data from properties that show a high degree of comparability to determine the value of a real asset. This approach rationale lies in the idea that well-informed investors will not pay more for a property than what other buyers have paid recently for properties with equal or very similar features.

Establishing comparability becomes a crucial aspect for the validity of this approach. Differences in size, scale, location, age, quality of materials, and other elements (e.g. number of elevators, landscaping, …) across properties must be appropriately factored. Besides, sales between related persons (e.g. a parent company and its subsidiaries) and transactions completed under special circumstances (e.g. foreclosures, sales involving public authorities) must not be considered.

Under the sales comparison approach, the value of a property is established as follows. First, \( n \) comparable properties that have recently been sold are selected. Next, a series of adjustments must be performed so that minor deviations are considered. Said adjustments are made relative to the property
of interest. Once comparability is effectively established, a suitable unit of comparison (e.g. adjusted price per square foot for office buildings, number of apartment units for condos, cubic feet for warehouses) will be selected.

The cost approach considers, for a new property, its total cost construction costs plus the market value of the land where it is located; and for existing assets, the estimate cost of replacing said property, discounting it given its current physical deterioration and obsolescence. This approach is based on the principle that an informed investor would not pay more for a property than its construction cost and the value of the land it occupies.

The cost approach, in sum, aims at determining the replacement cost of a property to its current state. In the calculation of said cost, data from comparable properties will be used, too. For relatively old properties, replacement cost calculation becomes an increasingly complex task, as adjustments for depreciation and obsolescence are difficult to value.

The income approach encompasses a set of techniques whose common rationale is that property value is related to the ability of an asset to produce future cash flows.

The first technique entails the calculation of gross income multipliers (GIM), the ratio of sales price over gross income generated by comparable properties to the one being appraised. Gross income can be potential (assuming that all the space of a property is occupied) or effective (i.e. potential gross income minus vacancies). As with the sales comparison approach, appropriate selection of comparable properties is important for the validity of the valuation estimate.

The second technique, direct capitalization, uses net operating income (NOI), which is the rental income and any other income generated by a property (e.g. fees, parking) at its effective occupation rate, net of its related expenses (e.g. taxes, insurance, utilities, maintenance and repair, salaries, leasing fees, improvements…). So as to obtain an estimate appraisal value \( V \), direct capitalization uses the capitalization rate \( R \) of comparable properties, which is the ratio of their NOI over their selling price \( R = \frac{NOI}{V} \). The average capitalization rate of comparable properties can be used to determine the estimated value of a properties whose NOI is known. Increasing capitalization rates indicate increasing NOI and/or decreasing property values.

A final technique, known as the discounted present value, provides estimate valuations based on the present value of all future NOIs of a property. This method inherently needs to use approximations of both future net operating income and discount rates.

3. Institutionalization of the student housing market

From an investment standpoint, institutionalization refers to the process of replacement of individual and smaller investors and operators by institutions, such as leading firms in the market or investment
funds, that now serve as intermediaries through which these smaller players pursue their investing activities (Krug, 2011).

Within the student housing market, we believe that there are four key traits of its structure that define its institutionalization:

A. Disappearance of the capitalization rate premium over traditional real estate asset classes

Real estate investment in student housing has gained importance globally since the global financial crisis of 2008 (French et al., 2018), having attracted increasingly large capital volumes from investors. Higher than average risk-adjusted returns and the diversification possibilities that student housing offers have attracted new players to the sector (Newell and Marzuki, 2018). Global property funds and investment management firms (e.g. BlackRock, Principal, Mapletree, Corestate) have increased their holding of student housing assets. Newell and Marzuki (2018) explore the entrance of “institutional investors” (e.g. global pension funds and sovereign wealth funds) and argue that their presence indicates the growing institutionalization of the sector worldwide.

Increases in capital flows into the student housing market lead to yield compression (Halliwell, 2017). Higher investor competition for student housing assets results in the disappearance of the traditional capitalization rate premium that student housing had over “traditional” asset classes in real estate (e.g. multi-family and office). We expect to observe higher degrees of institutionalization the smaller the difference in yields between student housing and other real estate classes is.

B. Professionalization of the supply of student housing

Professionalization of the supply is a key characteristic of an institutionalized student housing market. The emergence of specialized players in any market are a clear sign of supply undergoing a professional transformation, enhancing competitiveness amongst firms. In the case of student housing, universities have traditionally invested funds into providing student housing. Their lack of management know-how, however, has become an opportunity for specialized firms that reap the benefits of operational efficiency.

C. Substitution of direct investment for indirect investment vehicles

We also believe that a characteristic of an institutionalized market is the growing complexity of its investment vehicles. In the case of real estate investments this can be illustrated by the shift from direct investments vehicles to indirect investments vehicles. Direct investments imply buying a stake in an
entity that owns an asset and debt investments imply capitalizing a loan collateralized by real estate (Powderly, 2016). Indirect investments are understood as more complex investment vehicles where a pooling of capital happens to invest in real estate property. The proliferation of this type of investments is a sign of the increased appetite of investors for investments and the consequent development of ways to invest. Thus, it makes sense to us, to consider the increase in use of indirect investments as a indicator of the institutionalization level of a market.

Figure 1. Shift from direct investment vehicles to indirect investment vehicles

D. Consolidation of student housing companies and investors

Consolidation is a relevant indicator for the level of institutionalization of the student housing market. When organic growth becomes difficult due to external factors like competition and legal frameworks, consolidation through M&A activity proves the most effective growth strategy. Thus, mature and institutionalized markets will exhibit more consolidation activity.

The most relevant factor that sets the real estate industry apart from the general business environment is the existence of SOCIMIs. This figure has limited growth potential. SOCIMIs have to re-distribute a large portion of profits and thus organic growth becomes less feasible, making M&A an attractive growth alternative (Anderson, Medla, Rottke and Schiereck, 2012). Also, these legal figures have a very homogeneous asset bundle. This is understood to be a source for economies of scale with important savings in operational costs (Eichholtz and Kok, as cited in Anderson, Medla, Rottke and Schiereck, 2012).

4. The Spanish student housing market

In this part of the study, we will assess the current state of the Spanish student housing market in two steps: first, we will analyze the preliminary factors that act as foundation for the growing institutionalization, such as the market structure or the investment attractiveness. Then, the four
hypothesized determinants of institutionalization introduced in the previous section will be reviewed and compared internationally with the US and the UK industries.

A. Preliminary factors

In this section we will present the three factors that initially contributed to the process of institutionalization of the Spanish student housing market.

i. Economic factors of the Spanish economy

Overall, it can be said that economic activity in Spain in 2018 has evolved favorably. In 2018, the Spanish GDP increased a 2.6% with respect to 2017, according to OECD data. The GDP in Spain has been increasing since 2014 but in 2018 there has been a moderation in growth. This deceleration is expected to continue, and it might have been caused by the threatened political stability; the high levels of public and private debt; the high levels of unemployment and the many unproductive companies in the economy.

Despite the ease in the growth rate of the Spanish GDP, the country has continued being one of the countries with the highest GDP growth in the Eurozone. Moreover, the GDP per capita has been increasing accordingly year after year, since 2014, as the population as continued being stable at around 46 million. The low interest rates and the improvement of the employment situation seem to be the drivers of this growth in GDP.

On the one hand, the improvements in the job market have bolstered household income and consequently consumer spending making ultimately GDP grow. The improvements in the job market have not only been caused by a reduction in the unemployment rate, which went down from 16.5% in 2017 to 14.3% in 2018, but also by the appearance of strong employment gains, such as wage and pension increases.

On the other hand, the European Central Bank’s expansive and low interest policy has improved the financing terms for both the public and private sector which has increased investment and GDP. The improvement of the financing terms and the employment rate has supported the increase in domestic demand and in investments. Real Estate investments in Spain are characterized by being debt-financed and the low interests may explain the rise of real estate investments during 2018. Real estate investments have set new records during 2018 reaching more than €20 billion invested (CBRE Research, 2019b).

As a summary, although the GDP growth is expected to gradually slow, the real estate market has been seen as an attractive investment alternative in 2018 for both domestic and international investors. This
attractiveness in the Spanish economy has fostered investments and consequently the need for institutionalization.

**ii. The mismatch between supply and demand in the Spanish student housing market**

In the 2016/2017 academic year, according to the Ministry of Education, the number of students enrolled in the Spanish Higher Education System amounted to 1,558,685, growing 1.1% with respect to the previous period and, approximately, 10% since 2007/08 (Savills World Research, 2018). Specifically, bachelor enrollment grew by 1.2% while the number of master and PhD students increased by 8% and 20% respectively, showing a trend in the market for higher education pursuit (JLL, 2018).

Around 328,700 students are enrolled in a different province from the one they were born in; 25% in the case of public universities (282,719 students) and 28% in the case of the private ones (45,906 students). The regions that host the most students from other provinces, Andalucía, Madrid and Catalonia, saw this amount grow at a substantial rate (5%, 17% and 10%, respectively) from 2014/15 to 2015/16, showcasing the aforementioned growing interest in mobility within the Spanish market (JLL, 2018).

When it comes to international students permanently enrolled in the Spanish system, the figure is estimated to be of 98,741 students, 7.5% of the total number of students enrolled. Within the main levels of university education, they represented 4.8% of the undergraduates, 20.5% of the masters and 24.3% of the PhDs. In terms of growth, with respect to the previous period there was an increase of 10.2% (11.4% of undergraduates, 5.2% of masters and 16.2% of PhDs), while the CAGR (Compound Average Growth Rate) since 2009/10 amounts to 7% (JLL, 2018). All in all, among the students that are permanently enrolled, private universities are the ones that attract more potential seekers of student housing (41.2%, 27.7% coming from other provinces and 13.5% of international students), indicating also the higher purchasing power from this group.

Last but not least, Spain has been the leader in hosting Erasmus students since 2001. During 2016/17, they amounted to 48,595, a number that has been trending upwards since 2008/09 with a CAGR of 4.04% (EC, 2019).

Given the data mentioned above, it can be estimated that the total demand in the Spanish market during the 2016/17 academic year was of, approximately, 476,036 students, without taking into account the ones that need housing within their same province. That number by itself indicates the huge potential of this market, but it is important to understand what factors have driven it to assess its current and potential attractiveness.
First and foremost, the number of young population (between 18 and 24 years old) in Spain has been growing over the years and, according to the Spanish Statistical Office, it is expected to be 11% higher than in 2018 by 2025 (JLL, 2018).

The above-mentioned increase of the Spanish population wanting to pursue higher education may explain the growth of the intra-national mobility. Anyhow, this type of mobility still has a lot of room to grow, as 63% of the students still live with their parents, compared to the European mean of 36% (Xarxa Vives, 2019). A factor that may explain these figures is the fact that tuition fees in Spain are higher than in the rest of Europe. Apart from that, the percentage of students receiving needs-based grants, 28%, is still way below the mean among countries that have high intra-national mobility rates, like Finland, Sweden or Denmark, which is approximately 82% (Eurydice, 2018).

Recently, the two most voted political parties in Spain have shown interest in reducing the oversized supply of undergraduate degrees, which has increased 13% since 2007 (El Mundo, 2018) (OSU, 2019). In that case, presumably a lot of degrees in smaller and provincial universities would not be offered anymore, causing them to specialize. This sequence of events would unlock the aforementioned potential of the intra-national mobility, making more students move to the larger cities and, ultimately, increasing the demand for student housing.

Taking a look at the rest of the countries, it can be seen that most of them have internationalization strategies in place. The number of students that studied abroad is expected to almost double by 2025, reaching the figure of 8 million, compared to the 4.6 million recorded in 2015 (Savills World Research, 2017).

The increase in the offering of ETPs (English Taught Programs) is one of the main causes of this change. In this aspect, Spain places third but it is widely outperformed in terms of international enrollment by countries that are behind them in the list, like Germany, France or Italy (CBRE Research, 2019a).

After further studying the data, one of the facts that stands out is that China, who leads the outbound market with 17% of the total students (even though proportionally it sends half the students that Germany does), is the top country of origin of international students in the UK, US, Germany, France. However, in Spain it does not even appear in the top 3, formed by Colombia, Italy and Peru (Savills World Research, 2017). Furthermore, France attracts more students from Latin America than Spain itself (Perianes, 2018).

The reason behind this appears to be the lower reputation of Spanish universities compared to the aforementioned countries. Only 13 universities are part of the top 500 of QS, compared to 17 in France,
30 in Germany, 51 in the UK and 94 in the US (QS, 2019). Other aspects that also contribute are the low expenditure in fellowships (0.11% of the GDP, compared to the 0.31% OECD average) and the fact that most fellowships granted by foreign institutions are given to send their students to the best universities (Michavilla et al., 2015).

Anyhow, events such as the Brexit (possible increase in tuition fees and complicated bureaucracy), the rising popularity of international branch campuses and the anti-immigration nature of Trump’s administration are expected to weaken this effect and to redirect the demand towards the Spanish education system (Savills World Research, 2017).

Together with the main insights derived from the analysis of the demand side in the Spanish student housing market, understanding the key drivers underlying the supply side will also help explaining the investment potential and attractiveness of the sector.

When students look into different housing opportunities, they find two primary options: private accommodation in apartments/studios and bedrooms in student dorms. Though the main focus of this analysis will be on student dorms, private housing is still relevant in our study.

*Purpose built student housing (PBSH)* provides students accommodation with a number of extra facilities such as study spaces, common areas and, in some, full board is also offered. Demanding and sophisticated consumers push for innovation and further development to be made in infrastructure. Global trends, which also translate to Spain, are for dorms to evolve towards affordability, more study space and technology (Savills World Research, 2017).

Ownership and management of student dorms has a few different models. The more direct model is for the investor to directly lease to students via its own platform. There are also cases in which the investor enters an agreement with a university, which will do the management (known as university nomination agreements). This is also the case in Full Repairing and Insuring (FRI) based leases, where universities bear in full maintenance and insurance cost. The last form of ownership structure, university partnerships, is one in which the university is the owner of the asset and the operator enters a management agreement concession that generally lasts between 40 and 70 years (CBRE Research, 2019c). The latter form is very common in the Spanish market. Historically, however, the most common form of ownership and management in Spain has been for small domestic operators to control and manage one or few student dorms.

Supply in the Spanish market is rather concentrated, with the five largest operators controlling more than 15% of the bed count (JLL, 2018). The largest operator is RESA, with more than 9,000 beds. Other
large players include Nexo, with almost 1,500 beds, and public universities like UAB, Carlos III and UB with roughly 2,000, 1,000 and 900 beds, respectively.

The current stock in the Spanish market adds up to slightly more than 100,000 beds (French, Bhat, Matharu, Ortigao Guimaraes and Solomon, 2018). In relation to the overall number of enrolled students in the country, this adds up to 6%; a relatively small figure when compared to other European countries like the UK, France and The Netherlands, with 24%, 15% and 16% respectively (Savills World Research, 2017). The last 4 years show a constant increase in supply with an average yearly growth of almost 3% in bed count (JLL, 2018). Estimated growth in supply for 2019 is of 6.2% (JLL, 2018).

Even though this study focuses on the student dorm market, analyzing supply its alternatives is relevant for two main reasons. The first reason is the shortage for supply in student dorms in Spain. Alternative housing represents a very close substitute for consumers.

It should be mentioned that some dorm operators offer accommodation through their platforms in alternative facilities. This is a mixed solution, as it combines the flexibility of a short-term rent of a dorm with the benefits of living privately. Operators offering this solution are already tackling the lack of their own supply.

The lack of supply in student dorms and the rising prices charged for rent make for a general increase in student accommodation costs that leaves a large portion of potential demand unattended. According to CBRE Research, 2019b, lack of suitable supply is mentioned as one of the key drivers for international investment in this market. The investment potential is high given the imbalance in supply and demand. This growth is expected to be organic, with the development of new properties tailored to the needs of the demand. (CBRE Research, 2019b).

### iii. Student housing investments in the Spanish real estate market

Student housing has emerged as an asset class on its own, both in Spain and globally (JLL, 2012). Investments in student housing present a set of particular features that have made it particularly attractive for investors seeking high risk-adjusted returns and portfolio diversification:

- The economic performance of student housing is largely unaffected by macroeconomic cycles. On the one hand, price fluctuations of student housing properties are small, even in deep economic downturns. For example, while multifamily (e.g. condominiums and apartment
buildings) real estate prices fell by more than 20% between 2010 and 2012 in the US, student housing prices continued to increase, according to CBRE Research (2019c). Moreover, demand for student housing shows a counter-cyclical behavior, as the students place increased value on higher education during crisis periods.

- There exists a consistent mismatch between supply and demand: most markets present a chronic shortage of good quality supply of student housing. As explained before, the difference between the existing supply and the real demand for student housing in Spain was estimated to be of, approximately, 380,000 beds in 2017, according to JLL (2018). By 2018, despite new student housing developments, the gap has widened to 420,000 beds (JLL, 2019).

- The consistent over-demand of student housing leads to very high occupancy rates, with a growing prospective demand thanks to the inflows of international students in Spain.

- The periodic nature of accommodation rental fee payments insures steady income streams (Newell and Marzuki, 2018).

- Accommodation fees actualization and appreciation occur on an annual basis. The short-term nature of student housing leases, the high room turnover and the lack of regulation limiting price hikes (commonplace in multifamily real estate) provide student housing operators with improved pricing flexibility.

- Student accommodation does not present major future structural challenges. While retail and office real estate are threatened by the growth of online commerce and the rise of telecommuting, respectively, online higher education is not expected to substitute traditional, in-person teaching any time soon (Newell and Marzuki, 2018).

On the negative side, student housing properties suffer from higher average depreciation than other property classes. Due to the high usage intensity of student housing, annual maintenance costs are estimated to be 17% higher than the average annual depreciation of apartments (CBRE Research, 2019c).

B. Comparative analysis of the institutionalization of the Spanish student housing market

This section presents the main results of our analysis of the four hypothesized factors of institutionalization in the Spanish student housing market and compares it with the American and British markets.

i. Disappearance of the capitalization rate premium over traditional real estate asset classes

As mentioned before, the Spanish market is not an exception in the global trend of growing investor appetite for student housing. Total investment in student housing developments and acquisitions has
increased considerably in Spain in the last three years. In 2016, €50 million were invested, and by 2018, said figure had reached €141 million, according to JLL (2018).

In 2017, a total of €560 million were invested in the Spanish student housing market. The figure, an all-time high, includes the acquisition of RESA by Greystar (US), CBRE Global Investors (US) and AXA IM (France), valued at approximately €400 million (Ruiz, 2017). The fact that these three international property fund and investment management firms acquired the largest Spanish student housing operator highlights the international appetite for Spanish student housing and its increasing relevance within this new global asset class.

Also, in 2017, Global Student Accommodation (a British student housing firm with operations in 8 countries and 33 cities) acquired a portfolio of 2,234 beds from Spanish student housing operator Nexo Residencias and announced plans to invest up to €500 million in Spain’s student housing market until 2022 (GSA, 2017).

Further evidence of the increasing institutionalization of the Spanish student housing market is the entrance of the Canada Pension Plan Investment Board (CPPIB), Canada’s largest pension fund with more than $392 billion assets under management, into the Spanish market (Newell and Marzuki, 2018).

Profitability of student housing property, as measured via the capitalization rate, remains among the highest across all real estate classes in Spain. At the end of 2017, Spanish student housing yielded average returns of 5.25% (compared to the lower 3.75% yield of office buildings and residential properties) and only lower than logistics at 5.50% (JLL, 2018). Indeed, the Spanish student housing still presents a notable capitalization rate premium (of approximately 1.5%) over traditional real estate properties.

Nevertheless, the growing institutionalization of the Spanish student housing is putting increasing pressure on capitalization rates. The 2017 capitalization rate of the sector was 0.5% lower than the yield at the end of 2016, according to JLL (2018). The most recent data available further points towards increasing convergence in capitalization rates between student housing and traditional real estate classes (JLL, 2019).

Student housing capitalization rates in more mature markets, such as the UK and the US, show further convergence with those of more traditional property sectors. According to Cushman & Wakefield (2018), yields in UK student housing have fallen by 25 bps-100 bps between 2017 and 2018, depending on the region. Moreover, by the end of 2016, student housing showed a capitalization rate premium over apartments (multifamily assets) of barely 0.25% (Halliwell, 2017). In the US, capitalization rates in student housing averaged 5.56% at the end of 2018, down from 6.5% in 2014 (Anderson, 2019).
Similar to the UK market, the capitalization rate premium of student housing over multifamily assets has converged to just 0.25% since 2016, according to Costello (2018).

**ii. Professionalization of the supply of student housing**

A change in ownership form has, over the last years, boosted an important professionalization of the supply for student housing in the Spanish market. We observe a clear pattern of specialization and separation in ownership and management roles. As a consequence, firms in both roles have entered a steep professionalization curve and a shift towards a performance-oriented culture.

The student housing market structure in Spain has generally been a very fragmented one. In the 70’s and 80’s, when a large amount of housing was built, most dorms were privately owned and managed. A key aspect is that lies behind this fact is that religious orders have traditionally been largely involved in student housing (still accounting for more than 20% of the national supply; up to 40% in Madrid). This traditional form of fragmentation has shifted over time towards a much more concentrated market with new models of ownership. The five largest Spanish players hold now 15% of the national bed count and exhibit a clear pattern of ownership and management separation. The trend towards a clear separation of ownership and management is underway. University partnerships are the most common form in the Spanish market, where the university is the owner of the asset and the operator enters a management agreement concession that generally lasts between 40 and 70 years (CBRE Research, 2019c). There is thus, a clear distinction between the figures of the manager and the owner.

Separation in roles has also led to professionalization, especially in the management role. As mentioned previously, management is of key importance in student housing as it is a key aspect of the product/service bundle being offered. Specialized companies like RESA have become dominant in the market and the entry of international leaders in student housing management like Greystar are a clear indicator of an increased focus on the operational and efficiency factors of the business.

In terms of ownership, specialized players have also landed in the Spanish market, though to a lesser extent. As mentioned earlier, public entities (mostly universities) are still the most relevant players within the owner role. A public-private cooperation model is thus the most common operational form, where Universities build and lease the real estate to private management companies that have the business know-how. A good example is last year’s construction of Catalonia’s biggest residence hall in Barcelona, where ownership belongs to the University of Barcelona and management is left to Nexo Residencias, which in return will finance the project (La Vanguardia, 2018).

The last factor that is crucial in the professionalization of the supply is the already mentioned change in business mentality in the industry. Religious orders that engaged in the building of student housing
in the post-dictatorship era did not have business and performance as their main objectives. Their focus was on religious objectives and on maintaining a certain control on the student generations, with compulsory activities in their facilities (ABC, 2019). Less focus on proper management meant that there was plenty of space for improvement in business performance, which in turn is another trigger for investment appetite.

In more mature markets like the US and the UK, the last twenty years have been characterized by a strong privatization of public facilities. This business pressure has incentivized educational institutions to shift their resources to other activities, outsourcing housing to specialized firms. In fact, from fiscal 2008 to fiscal year 2016, state spending per student at public colleges in the US decreased 18 percent. Apart from that, the value of transactions involving universities and private investors has grown at a 50% rate year-over-year for project management companies like Brailsford & Dunlavey, indicating the increasing magnitude and importance of such operations in the market (Reuters, 2016). Both markets thus exhibit to a larger degree specialization patterns, as it is not universities anymore who assume the ownership of the facilities. In both ownership and management specialized firms are the most prominent in these Anglo-Saxon markets (Kathy King-Griswold, 2013).

### iii. Substitution of direct investment for indirect investment vehicles

The Spanish real estate market has experienced in the last decade a proliferation of more complex investment vehicles, so as to say, indirect investment vehicles.

For many years, real estate investments in Spain have been characterized by being of a direct nature. Either investors where owning a stake in a entity investing in real estate or they were capitalizing a loan collateralized by real estate. Indeed, the financial Spanish market in general has been characterized by a strong banking sector issuing direct vehicles (mortgage backed bonds and securities) to finance mortgage credits and ultimately boost the real estate market.

The institutionalization and consolidation of indirect investments in Spain can be explained by two important episodes: the creation of the Collective Investment Trust (CII) in 1992 and the introduction of the SOCIMIs in 2009.

The 19/1992 Act introduced the previously mentioned Real Estate Investment Funds (FIIs) and Real Estate Investment Trusts (SIIs) as well as mortgage security funds. The 1992 Act came into being after a period of recession (1992-1995) following a real estate and housing market boom and a rise in mortgage activity (Taltavull de la Paz, Peña Cuenca, 2013).
The introduction of these new real estate investment vehicles was aimed at achieving portfolio diversification through mortgage security funds and provide a solution for the weak rental market (as mentioned in the previous section) in Spain thanks to the FIIs and the SIIs.

The Spanish real estate sector has traditionally obtained its financing from banking institutions highly specialized in real estate loans and through the mortgage market (assets and credits) Developers also resorted to the credit system in seeking to finance building processes and commercial property companies used a combination of their own equity and mortgage loans to finance such projects.

As SIIs and FIIs had no big tax benefits, they lacked success and did not improve the Spanish rental market. Moreover, with the financial crisis of 2008, some tensions arose with the investment vehicles introduced by the ICC such as the SIIs, FIIs and mortgage backed funds.

On the one hand, FIIs suffered important liquidity problems during the 2008 crisis. These types of funds offered the possibility for investors to sell or buy their shares quasi-automatically. If an investor wanted to sell their share, the manager had to give the investor their funds back within a 2-month period. With the crisis, many investors panicked and asked their funds back and many FIIs had to close down due to liquidity problems.

On the other hand, since the year 2000 the popularity of mortgage backed security funds started to grow at a faster pace, as a consequence of the quick development of financial markets in Spain, an increasing real estate bubble and a credit boom (BBVA, 2014). In 2008, after the housing bubble burst, the use of mortgage backed security funds decreased abruptly.

While all the indirect investment vehicles introduced by the ICC suffered a tremendous shock in returns, international Real Estate Investments Trusts (REITs) maintained acceptable rates of return.

With the aim of replicating the success of REITs in the US or in the UK, in 2009, Spain introduced a new real estate investment vehicle, similar to the US REIT. This vehicle was introduced under the name of SOCIMI, Sociedades Anónimas Cotizadas de Inversión en el Mercado Inmobiliario.

The first SOCIMIs were inspired in SIIs and that is why they are very similar. This is the reason why nowadays the regulation of SOCIMIs enables SIIs to become SOCIMIs with simple legal formalities. (Taltavull de la Paz, Peña Cuenca, 2013).

The benefits of SOCIMIs are many. First, their fiscal attractiveness is focused on “channeling funds towards the rental house market” (Taltavull de la Paz, Peña Cuenca, 2013) which could solve the weak
Spanish rental market. Second, the fact that they are listed in stock exchanges makes them very transparent investment vehicles.

In 2012, so as to increase the attractiveness of SOCIMIs their regulation was modified by the 16/2012 Act of 27 December which introduced greater flexibility and advantages. This is when they became more popular among Spanish investors.

SOCIMIs have proved to be very successful in Spain, where the number of this type of investment vehicles has gone from 0 to 72 since 2012 (Aranda, 2019). Spain is nowadays the second country in the world with this type of investment structures, first being the US with 200 companies incorporated as REITs. In terms of stock exchange capitalization, Spain is the 10th country behind countries like United Kingdom, France, the Netherlands or Australia (EPRA, 2018). The expected trend is that SOCIMIs will merge into bigger companies in the coming years (Aranda, 2019).

The development of student housing REITs is more recent, but their success has also become clear in Spain with the appearance of specialized SOCIMIs in student housing such as “Student Properties Spain Socimi”.

Spain is an emerging state in comparison to UK where REITs are established and the US where REITs are in a mature stage. However, recent reports (EY, 2017) expect Spain to become an established REIT regime in the near future due to the recent proliferation of SOCIMIs in the country.

REITs have been present in the United States since the 60s. The US Real Estate Investment Trusts (REIT) market is the oldest and most established REIT market in the world (Stevenson, 2013). There are over 200 REIT student housing companies in the US.

REITS were introduced in the UK in 2007 and since their creation they proved to be successful. Indeed, in the recent years, many real estate companies are converting themselves into REITs (EPRA, 2018). In 2018 there were 52 REITs in the UK (EPRA, 2018) and student accommodation REITs have gained importance (Savills World Research, 2019).

iv. Consolidation of student housing companies and investors
As mentioned previously, consolidation serves as a clear indicator of a market being institutionalized and mature. This section will explore recent events in the Spanish student housing market and relate them to the theoretical framework regarding M&A activity. One motive stands out as the most relevant in the Spanish case: the lack of business know-how in the traditional student housing operators.
Inefficient management is concluded in a range of studies as the main motive for M&A activity in student housing in Spain. Inefficient management refers to firms with superior management knowledge acquiring firms with unexploited opportunities to cut costs and increase earnings. This is understood to be a consequence of larger and more competent players joining a market that is still young or developing (Anderson, Medla, Rottke and Schiereck, 2012). A clear example of firms merging in Spain is the purchase of Resa by AXA, CBRE and Greystar (Expansion, 2017). While AXA and CBRE act as owners of the investment, Greystar is an international leader in managing student housing. The motives for investing in the ownership are more return-oriented while the management side sees unexploited opportunities in operational terms. By adding Resa’s more than 9,000 beds to its portfolio, Greystar consolidates its position as global leader with more than 60,000 beds globally.

An example of a much more consolidated market is the UK. Unite Students is an accommodation fund that is the largest specialist fund in the UK. It holds more than 25,000 beds in the UK market and has recently undergone important consolidation activity, with a clear tendency towards market concentration (Savills World Research, 2014).

5. Conclusions

The robust economic performance of the Spanish economy with respect to other European countries since the financial and debt crisis of 2008-2012 and the structure of its student housing market, with a very large and increasing mismatch between supply and demand, can explain the recent surge in investor appetite for student accommodation in Spain. Indeed, these two specific characteristics of the Spanish explain the improved return-risk profile of Spanish student housing investments.

While the Spanish market shows clear signs of growing institutionalization, an individual review of the determinants explained in the last section leads us to conclude that other markets, namely the American and British markets, are ahead.

The capitalization rate premium of Spanish student housing over multifamily assets is still, on average, 5 times higher than the American and British one. Despite the increase in professionalization of the supply, ownership and management are still usually intertwined in Spain, where religious orders control a high relative volume of beds.

Even if Spain currently has a wide variety of indirect real estate investment vehicles (e.g. SOCIMIs), they are in a less mature state than other countries, such as the US or the UK. Notwithstanding that relevant M&A activity has taken place in the last two years (e.g. acquisitions of Resa and Nexo), Spanish student housing suppliers still show a low relative degree of concentration on an international basis.
In the future, we expect to see further convergence between the Spanish and international, more institutionalized student housing markets. However, we have identified two possible risks that could hinder this progress.

On one hand, changes in regulation affecting available construction space can have a significant impact. If regulators restrict the available amount of soil for construction, organic growth will be limited. This restriction could, nevertheless, contribute to a consolidation of the miss-match in demand and supply and, consequently, in the continuity of higher than average capitalization rates in student housing.

On the other hand, this convergence can also be very sensitive to the effect that Brexit and the increasing commercial tensions could have on the capital inflows. We have seen that, in Spain, both consolidation and professionalization of supply are directly linked to the entry of international players to the national market. Any sort of restriction imposed on this end could lead to capital inflows or cross-border operations that will slow the convergence towards an institutionalized market.
6. References


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